

**PUTTING THE OWNER IN THE BEST POSITION
FOR A SUCCESSFUL CONSTRUCTION PROJECT**

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Many local governments are embarking upon new construction projects. It all seems so simple. All you have to do is hire an architect or engineer to design the project, then find a contractor to build it, or for those who are able to do so, follow an alternative delivery method, such as design-build or construction manager at risk. The professionals do all the work. The Owner gets a fine, finished product at the end. What could go wrong?

Unfortunately, lots of things. The purpose of this paper is to briefly look at a number of areas in construction projects where problems frequently arise, and make common sense suggestions, both of a legal and practical nature, to avoid or correct the problems before they become major stumbling blocks to a successful project.

In order to be in the best position for a successful construction project, the Owner should: (1) adopt a good process for selecting the project professionals, (2) utilize well-drafted, Owner-friendly contract forms, (3) implement a diligent contract administration procedure, and (4) follow good conflict-resolution procedures. The Owner's attorney can help put the Owner into the best position for a successful construction project by helping the Owner develop good forms and follow good procedures.

I. GOOD PROCESS FOR SELECTING PROJECT PROFESSIONALS

The Owner should adopt a good process for selecting project professionals, and the Owner's attorney can assist the Owner in understanding its options and establishing a good procedure.

With regard to project engineers and architects, the Owner in most instances will be required to follow the procedures of the Professional Services Procurement Act, set out in Section 2254.001 of the Texas Government Code. The Owner should use this process to make a meaningful selection of the best qualified professionals for the project. Once the professionals are selected, the Owner should use them to carefully plan out the project.

When it comes to selecting the construction contractor, most local governmental entities have been required for many years to use the competitive bid process, or the design/bid/build method of construction for some or all of their projects. If the Owner is required to follow this method, the Owner will generally be required to select the lowest responsible bidder for the project. The Owner can, however, increase its odds of getting responsible bidders by establishing minimum qualifications for the contractor, where appropriate, and taking other measures to make sure that the lowest bidder is also a responsible bidder.

In recent years, however, the Texas legislature has authorized certain governmental entities to use alternative methods to competitive bid. Currently, cities, counties, school districts, junior colleges, hospital districts, certain water districts and water authorities, and defense base development authorities are authorized to use alternative construction delivery methods which allow the Owner to select a contractor on the basis of criteria other than sale price. In other words, the Owner can also take into

account the reputation of the contractor, past experience with the contractor, the quality of the contractor's work, and other relevant factors in making its selection. In addition, the alternative construction delivery methods allow methods for construction to be used in addition to design-bid-build, including construction manager at risk, design build, and job order contracting. In order to make a selection, the Owner should understand the advantages and disadvantages of the different alternative project delivery methods. These methods are discussed in Section B.

A. Selection of Architectural and Engineering Professional.

Careful preparation should go into the selection of the professionals who will work on a project and State laws governing the procurement of such professionals should be closely followed.

For most local governments, Section 2254.001 et seq. of the Texas Government Code, known as the Professional Services Procurement Act, sets out the method to be followed in selecting engineers and architects. Section 2254.004 provides that “[i]n procuring architectural, engineering or land surveying services, a governmental entity shall: (1) first select the most highly qualified provider of those services on the basis of demonstrated competence and qualifications; and (2) then attempt to negotiate with that provider a contract at a fair and reasonable price.” Under Section 2254.005, a contract entered into in violation of the provisions of the Professional Services Procurement Act is void.

Generally, in following this procedure, the Owner sends out a Request for Qualifications (“RFQ”) to professional firms, interviews the candidates, and then makes a selection based on the qualifications. A matrix or some other set of criteria is used for determining the qualifications for selection. The Owner ranks the candidates based on the evaluation, and begins negotiations with the first-ranked candidate. If the negotiations do not result in an agreement for services, the Owner must, in accordance with Section 2254.004(b) formally end negotiations with that professional and begin negotiations with the next most highly qualified professional identified by the Owner.

The RFQ should request information which shows the experience and expertise of the professionals. The RFQ should not request information on the fees which the professional would charge for its services, because Section 2254.003 of the Texas Government Code prohibits a governmental entity from awarding a contract for professional services on the basis of competitive bids. It may be possible to ask in general, what the professional would consider as a “fair and reasonable” professional fee for the services covered by the RFQ. *Attorney General Opinion No. JM-155* (1984). The Owner, however, is probably safer reserving questions on fees to the negotiation stage of the selection process.

The Owner should make its selection process meaningful, by drafting a comprehensive RFQ, and establishing a qualification-based selection process. In preparing its RFQ, the Owner should develop and set out in the RFQ:

- a comprehensive scope of services. This should be developed with the assistance or oversight of professionals. If the Owner does not have in-house professionals, it should consider contracting with a consultant to assist in developing the scope of services.
- a response form to be used in providing responses. This will help insure that the Owner gets the information it needs in a manageable size, and in a format which lends itself readily to comparison between the candidates. It will also help level the playing field between big national firms and small, local firms which may be just as qualified, but which do not have professional marketing staff to help in preparing a response.
- the time limit the Owner will spend negotiating an agreement.
- the specific contract form which the selected consultants will be required to use. The form can be included by reference and copies made available to firms.

- any specific information which the Owner wants to consider in making its evaluation, such as
 - a. experience in designing similar projects,
 - b. ability to complete the work within a specified time period, and
 - c. the experience and expertise of the professionals who will be actually assigned to the project (as opposed to highly qualified experts who may be employed by the firm, but who may not be assigned to the project)
- the matrix or other criteria on which selection will be based.

The Owner should set up a qualification-based selection process by:

- soliciting interested professional firms (get lists from other area governmental agencies) and letting solicited firms know who else is being solicited;
- developing evaluation criteria for the needed professional services;
- weighing the criteria by their relative importance;
- developing evaluation guidelines for evaluators;
- selecting an evaluation team based on expertise, experience, and diversity;
- using interviews to gauge the effectiveness of the consultant team, or as a tie-breaker. Be aware that large firms may list nationally-recognized experts as team members, who may not perform any services on the Owner's project.

Once the professional team is selected, the Owner should use its professionals effectively to help plan the project. For each proposed project, the project team, consisting of staff and outside professionals, should:

- define the project down to minor details;
- estimate the desired project's cost;
- develop a project schedule;
- perform a cash flow analysis;
- identify all potential issues that can delay the schedule and increase the cost of the project (for example, the need to perform environmental remediation at the site, or road work that will occur in the vicinity of the project during the proposed construction period);
- address the gaps identified in (d) and (e) and adjust the schedule and cost estimate with appropriate contingencies. (Do not neglect economic inflationary trends, particularly localized ones in the building industry such as cost increases or difficulty in obtaining specific materials); and
- set up a funding mechanism for the project (bonds, general funds, etc.).

While the steps listed above seem obvious, it is surprising how many times the Owner fails to follow one or more of these procedures, resulting in project delays and increased project costs. As an example, Owners often do not think about the need to conduct an environmental site assessment in connection with a construction project, particularly on property which it has owned for some time. The cost of having to abate lead or asbestos, or otherwise remediate property, can seriously increase the time and cost of a project, and can even render the project unfeasible. The Owner's attorney can help the Owner to avoid problems of this nature by assisting the Owner to adopt a planning process utilizing its professional staff and consultants.

B. Choosing a Delivery Method for Construction

The Owner should carefully follow the procedures set out in the law applicable to the Owner for selecting a construction contractor. Failure to do so may result in the contract being void, and criminal penalties for the officer or employee who fails to follow the requisite procedures. *See, e.g. Section 44.032 Texas Education Code; Section 271.029 Texas Government Code.* Most local governmental entities are required to use the competitive bid process in selecting a construction contractor for some or all of their projects. In this process, sometimes known as the design/bid/build process, the Owner first selects an architect/engineer to design the project by following applicable law. Once the design is complete, the Owner bids out the project based on the plans. The Owner will generally be required to select the lowest responsible bidder as the contractor for the project. This often creates problems because the lowest bidder may not be the best bidder, and unless there is some way to establish that the lowest bidder is not “responsible,” it may be difficult to avoid having to select the lowest bidder.

To increase the chances of getting a responsible bidder who can competently perform the work, the Owner can, where appropriate, require reasonable qualifications and experience from the contractor. For example, if the proposed project is a water treatment plant, hospital or other project of a complex or specialized nature, it is not unreasonable for the Owner to require the contractor to have had successful experience in building similar facilities.

If an Owner has repeated problems with a contractor who routinely bids on projects, the Owner can take steps to have the contractor disqualified from bidding on projects, because of his irresponsibility. Normally, the Owner will have to show a pattern of irresponsible behavior on contracts, such as failing to complete work, failing to pay subcontractors, defective work, etc. and should have good documentation to support its case.

If the Owner bids out a project and the lowest bidder comes in with a bid which is substantially below all of the other bids, this may be an indication that the lowest bidder has made an error in calculation, or worse still, doesn't know enough about the type of construction to have bid it correctly. The Owner should ask the lowest bidder to confirm the bid. If the bidder finds that he has made an error in his calculations, the Owner would be well advised to allow the bidder to withdraw his bid. If the bidder confirms his bid, the Owner may want to consider rejecting all bids and rebidding the project.

Under statutes authorizing the use of alternative construction delivery methods, the Owner, acting through its governing body, is required to select the alternative delivery method which provides the “best value” for the Owner. For each method, the Owner creates a set of selection criteria and a scoring system which will be set out in the solicitation documents, and which will be used as the basis in selecting the contractor. The selection criteria can include factors other than price, including the reputation of the contractor, the quality of his services, and other relevant criteria. Points will be assigned to each criterion, and the contractors will be rated based on their overall scores. The Owner then selects the contractor who provides the “best value” to the Owner, based on the selection criteria. The Owner must document the basis for its selection and make the evaluations public no later than the seventh day after it awards the contract.

Note that, in general, the alternative delivery methods can only be used for the construction of architectural projects – that is, the construction of buildings which are governed by accepted building codes, and not for civil engineering projects such as roads, water plants, utilities, wastewater plants, or similar projects. However, cities, counties and some other local governments are authorized to use construction manager at risk and competitive sealed proposals for civil engineering projects under Subchapter H of Chapter 271 of the Local Government Code, and design build under Subchapter J, Chapter 271. In addition, Section 252.0453 (d-1) of the Texas Local Government Code allows cities to use the competitive sealed proposal procedure prescribed in Section 271.116 of the Texas Local Government Code for these types of projects, if they require an expenditure of \$1.5 million or less.

The following is an outline of the alternative construction methods, an explanation of what they entail, and an industry assessment of the advantages and disadvantages of each.

1. **Competitive Bid (Design/Bid/Build).** This is the traditional method of construction, although the award is based on best value and not on lowest bid.
 - a. Method
 - The Owner selects an architect/engineer (“AE”) to design the project and develop construction documents [A local government would normally make its selection through a Request for Qualifications (“RFQ”).]
 - The Owner then advertises for bids based on the AE documents.
 - The Owner selects the bidder as the contractor.
 - If bids exceed the estimated/budgeted cost of project, Owner and AE have to modify design and rebid.
 - b. Advantages
 - It’s a familiar system for many Owners.
 - The scope of the project is well-defined through the A/E process.
 - There is competition for the contract price.
 - The method is best suited to new projects that are not schedule sensitive or subject to potential change.
 - c. Disadvantages
 - This is a slow delivery method, because the design has to be complete before the project can be bid, then the Owner has to go through the bid process.
 - The contractor does not have any input in the design phase.
 - The method fosters adversarial relationships between the parties.
 - There is not much flexibility for change in this system.
 - This is not a good method for projects that are schedule or sequence sensitive.
2. **Competitive Sealed Proposals.** This method is similar to Competitive Bid, except that the Owner has some ability to negotiate the proposal with the contractor prior to award.
 - a. Method
 - The Owner selects AE to design the project and develop construction documents, normally through an RFQ.
 - The Owner then seeks sealed proposals based on the AE documents.
 - The Owner selects the contractor based on its proposal.
 - b. Advantages
 - The scope of the project is well-defined through the A/E process.
 - There is competition for the contract price.
 - This method is best suited to new projects that are not schedule sensitive or subject to potential change.
 - c. Disadvantages
 - This is a slow delivery method, because the design has to be complete before the project can be submitted for proposals, then the Owner has to go through the selection process.
 - The contractor does not have any input in the design phase.
 - This method fosters adversarial relationships between the parties.
 - This is not a good method for projects that are schedule or sequence sensitive.

3. **Construction Manager at Risk.** In this method, the Construction Manager provides pre-construction phase services and serves as the general contractor. The contract may provide for a guaranteed maximum price (“GMP”) for construction.

a. Method

- The Owner selects the A/E to design the project and prepare the construction documents, normally through an RFQ.
- At the same time, the Owner selects the Construction Manager at Risk (“CMR”), through an RFQ/RFP or RFP process as provided by statute. There is no need to wait for the design to be complete.
- While the project is being designed, the CMR provides preconstruction services by interacting with the A/E. The CMR helps to determine:
Constructability – can the project be constructed as designed?
Costing – estimate of cost taking into account local market conditions, such as labor costs and availability of materials
Value Engineering – now that the contractor knows what the architect has in mind, how can he achieve the same thing for less cost?

The contractor’s input may result in beneficial changes being made to the plans before construction begins, without have to resort to change orders during construction.

- Once the construction phase begins, the CMR is just like any other general contractor.
- The CMR serves as general contractor on the project, provides bonds for project and bids out trade contracts (i.e. subcontracting work). CMR may also perform some of the construction.
- Because the contract is entered into before the architectural plans are complete, there is no purchase price in the contract initially. The contract will provide that the contractor has to make a price proposal once the plans are developed. The Owner can either accept the proposal, in which case the contractor proceeds with construction, or reject the proposal in which case the contract terminates.
- Once the contract price is established, the contract generally provides that this is a guaranteed maximum price (“GMP”). In other words, the contractor takes the “risk” that the work can be performed for the GMP.
- It is still possible that the cost of the project will be increased by change orders, but theoretically, the need for change order should be reduced due to the CMR’s preconstruction services. Also, the GMP includes padding for contingencies.

b. Advantages

- Faster schedule for delivery, because you don’t have to wait for design to be completed in order to select the contractor. You don’t even have to wait for the design to be complete before construction begins, if the project is fast-tracked.
- The CMR provides assistance with design phase to reduce the project cost, the need for change orders and delays during construction phase due to design problems.
- More flexibility in selection of contractor.
- Architect and contractor act as a team, so less of an adversarial relationship (theoretically).
- Method provides more ability to handle change in project scope.
- Best suited to large new or renovation projects that are schedule sensitive, difficult to define, or subject to potential change.

- c. Disadvantages
 - It is difficult for the Owner to evaluate the GMP or determine whether best price has been obtained for the work, because there are no bids to compare it with.
 - This is not a good method for small projects.

- 4. **Construction Manager as Agent.** This is a method where the Construction Manager generally serves as a project manager, and does not have any responsibility for design and or construction. This method is sometimes referred to as a “multiple prime contractors structure.”
 - a. Method
 - Owner selects A/E to design project and prepare construction documents.
 - Owner selects Construction Manager as Agent (“CMA”), usually through RFP. CMA provides pre-construction phase services (like CMR), but doesn’t contract with trade contractors or provide bonds for project.
 - Owner contracts with each trade contractor directly.
 - CMA oversees and coordinates work by trade contractors
 - b. Advantages
 - The CMA provides assistance with design phase (just like CMR) to reduce project cost, the need for change orders, and delays during construction phase due to design problems.
 - Architect and contractor act as a team, so less of an adversarial relationship.
 - This method provides more ability to handle change in project scope.
 - This method is best suited to large new or renovation projects that are schedule sensitive, difficult to define, or subject to potential change.
 - c. Disadvantages
 - The Owner has to manage more contracts.
 - There is no guaranteed maximum price.
 - There is no single point of responsibility for construction.
 - This is not a good method for small projects.

Note: Even though the CMA method is considered an alternative delivery method, a CMA who is not responsible for construction and does not guarantee the construction price is really performing a professional service which would normally come under the Professional Services Procurement Act. Consequently, most local governments can hire a CMA to serve as a project manager for a project (particularly complex or specialized projects) even if they use the traditional competitive bid method of construction. If the Owner is a school district or junior college, however, the Owner may have to follow the exact procedures set out in the Education Code. *See Attorney General Opinion JC-0224 (2000).*

- 5. **Design/Build.** This is a method where the Owner contracts with a single entity to design and build the project.
 - a. Method
 - Owner selections an A/E to serve as the Owner’s project professional
 - The Owner’s A/E helps develop a design-criteria for the project
 - Owner goes through the statutory process to select a Design/Build Team, consisting of A/E and contractor which will then design and build the project based on the design criteria
 - b. Advantages
 - Faster schedule for delivery
 - Less adversarial relationship between team members

- The contractor provides assistance during design phase.
 - Best for new or renovation projects that are time-sensitive.
- c. Disadvantages
- Considered a sophisticated method, and Owner must have clear idea of project design and concept before selection.
 - This is a difficult method for the typical Owner to manage.
 - No checks and balances between architect and contractor.
 - Potential for conflict between Owner and Design/Build Team.
 - This is not a good method for projects that are difficult to define and are less time-sensitive.

II. DEVELOPING GOOD CONTRACT FORMS

A. Professional Services Agreements

The contract for professional services will dictate the entire relationship between the Owner and the professional, and will determine the outcome of most disputes, although the Owner will probably not have cause to find this out until there is a problem with the services, the project, or both. The Owner's attorney can help the Owner by making sure that the agreement for professional services adequately addresses the obligations and liability of the professional.

Many attorneys use AIA contracts because they are readily available and have a significant body of caselaw interpreting them. Most construction law attorneys who represent owners generally feel that AIA forms require modification in order to better protect the interests of the Owner. Many large architectural and engineering firms have their own professional services agreement forms. The Owner should never use any contract provided by the A/E without having the Owner's attorney review it first.

The Owner's attorney will want to make sure that any contract used for architectural or engineering services:

1. specifies the scope of work during the design phase, contract document preparation phase, and during construction phase. [If the Owner anticipates that the professional's attendance will be required at a number of public hearings, meetings with the Owner's governing body, or meetings with staff and neighborhood groups, the contract should require attendance and state whether attendance is within the basic scope of services or is to be considered extra work. Any redesign services required to bring the project into line with bids should be within the basic scope of services.]
2. sets out the standard of care for services;
3. sets out performance measures, design standards, documentation requirements and key milestones and ties payment to milestones achieved;
4. states adequate insurance requirements, particularly requirements for professional liability insurance, and indicates whether self-insurance is acceptable;
5. provides the Owner with all the rights it needs to use the professional's design and contract documents, which may include:
 - a. the right to use the professional's work for the project, even if the professional is terminated;
 - b. the right to use the professional's work for future alterations, additions or renovations;

- c. the right to use the work for other projects;
 - d. the right to reproduce the work.
6. contains a termination for convenience provision which is favorable to the Owner, and which does not require the Owner to:
 - a. pay for any amounts other than services completed to date of termination which are performed in accordance with the contract requirements (the professional should not be entitled to compensation for services which don't meet performance standards);
 - b. assume any obligation for subconsultant contracts;
 - c. pay the professional a termination fee;
 7. sets out adequate remedies in the event of default, including the right of the Owner to withhold payments, and to terminate the contract without diminishing the right to sue for damages;
 8. does not contain excessive exculpatory language or limitations on liability, such as:
 - a. unreasonably limiting the professional's responsibility for cost estimates;
 - b. limiting the professional's liability for errors to remedying them at no cost to Owner;
 - c. limiting the Owner's ability to sue for damages for a period of time after completion of the services (e.g. one year);
 - d. limiting Owner's remedies to actual damages;
 - e. setting a dollar amount, particularly an inadequate one, on the professional's liability; and
 - f. limiting liability to acts of gross negligence and intentional misconduct.

When going through the process of selecting the architect or engineer, it is a good idea to include in the RFQ the contract form which the Owner wants to use. This will cut down in the negotiating time and make sure that provisions favorable to the Owner are included in the contract.

Insurance is a very important consideration in a professional service contract, particularly professional liability coverage. A sample of insurance requirements for a professional service agreement is attached. The amount of coverage should be established by a risk manager or insurance consultant who is knowledgeable about commercial construction or public works projects. If the Owner does not have these resources available, it should consider contacting another government that has a risk manager or which routinely engages in large public work projects and determine what matrix or standards it applies.

In negotiating contracts for architectural services, it is important to remember that architectural work is protected by copyright law under the Architectural Works Copyright Protections Act of 1990, which constitutes an amendment to Section 101 of the Copyright Act of 1976. (Pub. L. No. 101-650. 1-04 Stat. 5089, 5133)

Copyright law protects five exclusive rights in the author:

1. the right to reproduce copies;
2. the right to sell and distribute copies;
3. the right to prepare derivative works;
4. the right to publicly display the works;
5. the right to perform the works; as well as the right to authorize others to exercise these rights.

These rights may be sold individually or all together in exclusive transfers, nonexclusive licenses, or in a complete transfer of the copyright.

The attorney representing the Owner should be certain to secure all the rights needed for the uses anticipated in the Professional Services Agreement. As stated above, these rights may include the right to use the architects' work for the project, even if the architect is terminated, the right to use the work for future alterations, additions or renovations, and the right to use the work for other projects. The right to reproduce copies should also be addressed. If the Owner wants the exclusive right to use the design and materials, this must be carefully negotiated. It would be advisable to have an attorney knowledgeable about copyright law involved in the negotiations.

Note: For those who uses AIA forms, the AIA Document B-141-1997, Standard Form of Agreement between Owner and Architect generally permits use of the Architect's work only in connection with the project, not for future alterations or renovations. Paragraph 1.3.2 of B-141 provides in relevant part [emphasis added]:

1.3.2.1 Drawings, specifications and other documents, including those in electronic form prepared by the Architect and the Architect's consultants are Instruments of Service *for use solely with respect to this Project*. The Architect and the Architect's consultants shall be deemed the authors and owners of their respective Instruments of Service and shall retain all common law, statutory and other reserved rights, including copyrights.

1.3.2.2 Upon execution of this Agreement, the Architect grants to the Owner *a nonexclusive license to reproduce the Architect's Instruments of Service solely for the purposes of constructing, using and maintaining the Project*, provided the Owner shall comply with all obligations, including prompt payment of all sums when due....

1.3.2.3 Except for the licenses granted in subparagraph 1.3.2.2, no other license or right shall be deemed granted or implied under this Agreement.... The Owner *shall not use the instruments of service for future additions or alterations to this Project or for other Projects*, unless the Owner obtains the prior written agreement of the Architect....

The Owner's attorney will probably want to change this provision.

B. Construction Contracts

It is imperative that the Owner utilize a construction contract which adequately protects its interest. The purpose of the construction contract is to define the project, specify the scope and quality of construction, establish the time-frame for performance and the cost of the construction to Owner, assign responsibilities, and allocate risks.

Generally in a construction project, the construction contract consists of the:

1. Basic Agreement between the Owner and the contractor which describes the project and the contract documents and specifies the construction price and the time to complete;
2. General Conditions, which state the administrative details of the project;
3. Special or Supplemental Conditions, which are terms which modify or supplement the general conditions for a particular project, such as adding a requirement for environmental liability insurance, if the project requires asbestos removal or environmental remediation;
4. Plans, which are the architectural and engineering drawings for the project;
5. Specifications, which are the details for the construction of the project;
6. Timelines, and other submittals required of the contractor by the contract;

7. Change Orders, which are written (or oral) changes to the contract which alter the plans or specifications, resulting in a change in the time for performance and/or the construction price (Note that Field Orders, which are minor changes in, or interpretations of, the plans or specifications which do not result in a change in time or cost, may also constitute part of the contract); and

8. Other technical manuals, project manuals or addenda specifically incorporated into the contract.

The construction contract is the main tool for addressing problems as they arise in a construction project. If the contract anticipates problems, and provides the Owner with adequate methods to address them by allocating risks and prescribing available remedies, then the Owner is in the best possible position to resolve or defend claims without having to resort to litigation. Any attorney who has had to prosecute or defend against a claim under a contract which does not allocate the risks, or provide adequate remedies, has a heightened appreciation for a well-drafted contract.

If an Owner does not have its own contract form, there are a number of contract forms available for use, such as those prepared by the American Institute of Architect (AIA). In representing the Owner, it is not advisable to use any of these forms unless they have been modified to better represent the interests of the Owner.

A large number of construction disputes arise out of or involve:

1. Delays in the project;
2. Responsibility for increased project costs arising from errors in plans and specifications furnished by the Owner;
3. Responsibility for delays and increased project costs arising from concealed conditions or changes in condition of the project;
4. Third party claims for damages or failure to pay subcontractors;
5. Liquidated damages provisions.

In order to adequately establish the construction requirements and address the areas most susceptible to disputes, the Owner's construction contract form should:

1. Define the project;
2. Specify the scope and quality of construction;
3. Establish the time-frame for performance of the work;
4. Establish the cost of the construction to Owner, with payments tied to the percentage of completion or milestones reached;
5. Establish the amount of retainage;
6. Contain a "no damages for delay" clause;
7. Allocate risk for errors in plans and specifications in a fair manner;
8. Allocate the risk for concealed conditions or for changes in condition in a fair manner;
9. Contain a liquidated damages provision based on reasonable costs to Owner;
10. Contain adequate insurance and bond requirements;
11. Contain adequate remedies for default, including provisions which allow the Owner to terminate the contract, withhold funds, and sue for damages (both actual and consequential) in the event of a contractor default;

12. Contain provisions which require the contractor to file a claim within a reasonable period of time after the contractor knows, or should reasonably know, of the cause for the claim;

13. Contain a provision that once a change order is executed by both parties, the contractor cannot claim additional compensation or time for the subject matter of the change order;

14. Set out all provisions required in connection with government construction contracts, such as prevailing wage rates and representations that the contractor has worker's compensation insurance.

Damages for Delays. In order to protect the Owner, the Owner's attorney should make sure that the construction contract contains provisions addressing liability for project delays. Normally, the contract should require the contractor to be liable for delays caused by the acts or omissions of the contractor, a subcontractor or supplier. Delays caused by acts of God are normally addressed in a force majeure clause which allows an extension of time for performance, but no monetary recovery, for delays which arise from causes beyond the reasonable control of the parties. An Owner will be liable for delays which result from the acts or omissions of the Owner, and which actually delay or hinder the contractor's work, resulting in damages to the contractor, unless the contract limits the Owner's liability through an enforceable "no damages for delay" clause.

In *City of Houston v. RF Ball Construction Co.*, 570 SW2d 75 (Tex. Civ. App. – Houston [14th District] 1978, writ ref'd n.r.e.), the Court upheld the enforceability of a "no damages for delay" clause similar to the following one:

contractor shall receive no compensation for delays or hindrance to the work, except when direct and unavoidable extra cost to contractor is caused by failure of the Owner to provide information or material, if any, which is to be furnished by Owner or access to the work. When such extra compensation is claimed a written statement thereof shall be presented by contractor to Owner and if by Owner found correct shall be approved. If delay is caused by specific orders given by Owner to stop work or by performance of extra work or by failure of Owner to provide material or necessary instructions for carrying on the work, then such delay will entitle contractor to an equivalent extension of time, contractor's application of which shall, however, be subject to approval of Owner. No such extension of time shall release contractor or surety on its performance bond from all contractors' obligations hereunder, which shall remain in full force until discharge of the Contract.

This provision does not relieve the Owner of all liability for Owner-caused delays, it limits the activities of the Owner for which delay damages may be claimed and restricts the Owner's liability to "unavoidable direct costs and an extension of time", thereby relieving the Owner of liability for consequential damages.

It should be noted, however, that a Court may refuse to enforce a "no damages for delay" clause when the delay was not intended or contemplated by the parties to fall within the scope of the provision; resulted from bad faith acts of the one seeking the benefit of the clause; has extended for such an unreasonable time that the party delayed would have been justified in abandoning the contract; is not within the specific delays enumerated by the contract, or results from arbitrary or capricious acts. See *Green International v. Solis*, 951 SW2d 384 (Tex 1997); *Jensen Construction Co. v. Dallas County*, 920 SW2d 761 (Tex. App –Dallas, 1996) writ denied.

Concealed Conditions and Changes in Condition. Normally, a contractor who encounters unforeseen or unexpected conditions on the site is liable to perform his obligations under the construction contract without being entitled to additional compensation. See, e.g. *Brown-McKee, Inc. v. Western Beef, Inc.*, 538 S.W.2d 840 (Tex. Civ. App – Amarillo 1976, writ ref'd n.r.e.) This can result in a substantial

hardship to the contractor where an unexpected condition, not within the contemplation of the parties, arises during the course of construction. An example would be where both the contractor and the Owner reasonably believe that one type of soil prevails in the construction site, but find unexpectedly during the course of construction that another type of soil, which makes construction more difficult and expensive, in fact prevails. Many contracts provide relief to the contractor by allowing him to obtain additional reasonable compensation, if concealed conditions or changed conditions arise which are materially different from those contemplated by the parties when they entered into the contract.

Insurance and Bond Requirements. The Owner should seek the assistance of a risk manager in establishing insurance requirements and coverage amounts, and all requirements should be stated in the contract. Attached is a sample of standard insurance requirements for a construction contract. The amount of coverage required to adequately protect the Owner and third parties depends in part on the nature and complexity of the project. If environmental remediation is required in connection with the project, including, but not limited to, the abatement and transportation of asbestos containing materials, environmental insurance should be required in connection with the activities performed by the environmental consultant or contractor.

It is important to have the contract set out the bonds required to be provided by the contractor in connection with the project. Bond requirements for public works projects are set out in Section 2253.021, *et seq.* of the Texas Government Code. If the contract is in excess of \$100,000, the contractor is required to provide a performance bond in the amount of the contract, executed to the Owner, prior to performing work. The performance bond must be conditioned on the faithful performance of the work in accordance with the plans, specifications and contract documents. The purpose of the performance bond is to protect the Owner by requiring the surety to take over the contractor's obligations and complete the project, or pay the Owner an amount not to exceed the face amount of the bond.

If the contract is in excess of \$25,000, (\$50,000 for cities and certain airport authorities) the contractor is required to provide a payment bond in the amount of the contract, executed to the Owner, prior to performing work. The purpose of payment bonds is to protect the subcontractors who furnish services or materials for the construction project, since they are unable to obtain a lien on the public works project. Under Section 2253.027 of the Texas Government Code, an Owner who fails to obtain a required payment bond becomes liable for all payments which a surety would be liable for in connection with a payment bond, and the unpaid subcontractor is entitled to a lien on money due to the general contractor.

If no bonds are required for the project, the Owner should consider having a contract provision which does not obligate the Owner to make any payments until all construction is complete.

Remedies. To fully protect the Owner, it is important that the contract provide the Owner with the right to terminate for convenience and adequate remedies in the event of a default by the contractor. The contract should expressly state that remedies are cumulative and not exclusive, and should include the right to withhold further payments, terminate the contract, sue for damages (both actual and consequential) and pursue any other remedy available at law or equity. The right to withhold payments becomes a very effective mechanism for resolving disputes, particularly when the Owner is trying to get the contractor to finish out the project by providing required documentation or completing punch-list items.

For those who use AIA forms, note that the AIA 201 1997 General Conditions contains a mutual waiver of consequential damages. In most instances, it is the Owner, rather than the contractor, who will be able to establish and obtain consequential damages for a default under the construction contract. This may not be a provision which the Owner will want to have in its construction contract.

Liquidated Damages. It is often beneficial to have a contract provision which allows the Owner to assess liquidated damages in the event of a delay in construction beyond the date for substantial completion specified in the contract. Liquidated damages provisions are enforceable if the stated amount is reasonable compensation for a breach, actual damages are difficult or impossible to calculate, and the clause does not constitute a penalty. *Loggins Construction Co. v. Stephen F. Austin State University Board of Regents*, 543 S.W.2d 682 (Tex. Civ. App. – Tyler 1976, writ ref'd n.r.e.). In order to establish that the liquidated damages are reasonable compensation, the Owner normally needs to estimate the costs it will incur in additional expenses, fees, overtime, and salaries for each day in which the completion of the work is delayed. If the Owner may become liable for penalties for noncompliance with laws which the construction was intended to address, these amounts should be calculated into the liquidated damages provisions. If the project is revenue generating, such as a convention center or hospital, then an estimate of lost net income would be used in the calculation.

Other Provisions. The contract should set out provisions covering all requirements peculiar to government construction contracts. Two examples are prevailing wage rates and contractor's certification of worker's compensation insurance requirements. Under Sections 2258.021 and 2258.023 of the Texas Government Code, a contractor who has a contract with a political subdivision, and all subcontractors on the project, are required to pay workers "not less than the general prevailing rate of per diem wages for work of a similar character in the locality which the work is performed, for regular days, holidays, and overtime work." The political subdivision is required to determine the general prevailing rate of per diem wages in the locality in which the work is to be performed in accordance with Section 2258.022 of the Texas Government Code. The contract should therefore contain a requirement that the general contractor pay the prevailing wage rate and that all subcontracts entered into by the general contractor require subcontractors to pay the prevailing wage rate.

Section 406.096 of the Texas Labor Code requires governmental entities to require the contractor to certify in writing that it has worker's compensation insurance. This certification should be provided as part of the contract award process.

Section 2251.021 of the Texas Government Code provides that interest on overdue payments shall accrue at the rate the prime rate as published in the Wall Street Journal on the first day of July of the preceding fiscal year that does not fall on a Saturday or Sunday plus 1%.

III. GOOD CONTRACT ADMINISTRATION PROCEDURES

The Owner should establish a good contract administration procedure, which includes, among other things, a method of determining that professional service agreements and construction contracts are signed by authorized persons, insurance requirements are met, as established by certificates of insurance, and all bonds required by the construction contract have been provided, before a notice to proceed is issued. The Owner should also have a method of inspecting construction to make sure that the amounts invoiced are really owed, that the contractor has provided all documentation, and that lien waivers are obtained.

The Contract Administration system should address the following:

1. Contract Authorization
 - a. The contracting party should provide a corporate resolution, copy of partnership or joint venture agreement, or other appropriate organizational documents to show that the persons signing on its behalf are authorized to do so, and to bind the principals.

2. Insurance Requirements -- Staff should review each insurance certificate to make sure it:
 - a. Is issued by the insurance agency, and signed by an agent;
 - b. Correctly states the name of the contractor (not a similar sounding name),
 - c. Shows the Owner as an additional insured in accordance with the contract requirements, and any endorsement required for notice before cancellation of coverage,
 - d. Correctly sets out all of the types of coverage required by the contract, showing the correct dollar amount of coverage and giving policy numbers;
 - e. Shows as insurers companies which meet the Best rating or other criteria set out in the contracts;
 - f. If the contract is with a joint venture, and professional liability insurance is maintained by only one of the venturers, the Owner will need to determine that the coverage is adequate to protect against the acts or omissions of both venturers.

3. Bond requirements:

The Bonds and the Bond Powers of Attorney should be provided to contract administration staff. Staff should review the bonds to make sure they:

- a. Are consistent with contract requirements, *e.g.* payment and/or performance bonds;
- b. Are on the form required by the Owner;
- c. Are signed by the contractor and by a person designated to act on behalf of the corporate surety under the Bond Power of Attorney;
- d. Are issued to the Owner,
- e. Show the correct contract amount and project designation.

Staff should review the Bond Power of Attorney to make sure:

- a. The person designated in the Power of Attorney to act on behalf of the corporate surety in fact signed the bonds;
- b. The type and amount of bonds are consistent with any limitations stated in the Bond Power of Attorney;
- c. The bond Power of Attorney and the bonds were signed before any stated expiration date for the authorization.

4. Payments

The project manager or other staff should establish a procedure with the AE to:

- a. Review invoices and requests for payment to make sure that payment is authorized;
- b. Inspect construction when necessary;
- c. Request all documentation to be provided by contractor, including a list of all subcontractors and suppliers;
- d. Obtain lien waivers from the subcontractors, suppliers and prime contractors.

IV. GOOD DISPUTE RESOLUTION PROCEDURES

Even if the Owner has followed good selection procedures, used good contract forms and employed good contract administration procedures, contract problems can arise. Contractors don't perform the

work in accordance with contract requirements, poor scheduling or project management result in project delays, subcontractors don't get paid and walk the job. When problems do occur, it is important for the Owner to establish a good system of dealing with them

1. All problems should be dealt with promptly.
2. Bring the problem to the attention of the contractor and give him an opportunity to explain or fix it. Ideally, this should be done in writing.
3. If the problem isn't fixed or recurs notify the contractor in writing. Put him on notice that you will pursue remedies available under your contract, or, if the problem is serious, take action under the contract, such as withholding payments, after the time period for any notice has expired. Copy the surety on the correspondence.
4. Set up a meeting with the contractor to discuss the problem and find out what steps he intends to take to fix the problem or to keep it from recurring. Take notes of the meeting. Send a letter to the contractor and surety after the meeting setting out what the contractor has agreed to do.
5. If the problem continues, notify the surety and take action under the contract or bond.
6. Be fair in resolving disputes. If the Owner has some culpability, factor that in.
7. The Owner should not get involved in subcontract disputes between the contractor and a subcontractor.

Early intervention, providing the contractor with the opportunity to correct problems, monitoring progress, documenting the problems and taking decisive action when it seems apparent that the project has a serious problem, is the best approach to take. It is very important to document problems in writing. It provides a record which shows not only the dates on which events occurred, but evidence that the Owner gave notice and opportunity to cure.

Often Owners are reluctant to notify the surety when there is a problem. This is because the Owner has often built up a working relationship with the contractor, and doesn't want to upset the contractor by notifying the surety. The Owner's attorney can help by being the person to write the letters and contact the surety. The surety can really help get problems straightened out because the surety wants to make sure that it doesn't have to pay out any money to fix a contract problem, and the contractor is usually responsive to the surety because he doesn't want to have problems getting bonded in the future.

If problems do get serious, and the Owner has to take action under the contract or performance bond, he'll be glad that the contract provides adequate remedies to protect him, and that the bond is in place and can be relied upon.